

[Home](#) > [Businesses](#) > [Help & Resources](#) > [Legal Library](#) > [Letter Rulings](#) > [Letter Rulings - By Year\(s\)](#) > [\(2000-2004\) Rulings](#) >

Letter Ruling 00-3: Computer Sales Inventory Items used for Demonstration

February 10, 2000

You request a letter ruling on behalf of ***** ("Taxpayer") regarding the application of the Massachusetts use tax, G.L. c. 64I, to certain items withdrawn from sales inventory for use at the Taxpayer's "Enterprise Technology Center" in Massachusetts and subsequently returned to sales inventory.

Facts

The Taxpayer has stated the following facts:

Taxpayer designs, manufactures, and sells computer hardware and software. All manufacturing occurs outside Massachusetts. Taxpayer operates an "Enterprise Technology Center" ("ETC") in Massachusetts.

1. The Inventory Items

Taxpayer has been reporting Massachusetts use tax on certain inventory withdrawals of items of tangible personal property for use at the ETC. The items are comprised of equipment manufactured by Taxpayer outside the Commonwealth, such as servers, workstations, storage cabinets/arrays, and components of these items. These items are removed from and subsequently restored to a manufacturing WIP (Work-In-Process) inventory account, and a raw materials inventory account. Both are for-sale inventories.

Taxpayer rotates sales inventory items into the ETC for not more than ninety days before returning them to sales inventory. Taxpayer selects the items needed for a particular ETC project, i.e., the number of CPUs, Memory, and/or disks required. Taxpayer does not segregate the items returned to inventory, and sells them at the regular price. Taxpayer does not depreciate these items.

2. The ETC

The ETC is a permanent laboratory testing and demonstration facility. It is part of Taxpayer's division responsible for sales of computers and servers. The ETC does not test sample inventory for quality control. The ETC does not conduct customer training. The ETC uses the equipment only to demonstrate performance to prospective customers and to run industry standard benchmark tests.

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A. Demonstration to Prospective Customers

At the ETC, Taxpayer assembles inventory items into large, uniquely configured integrated systems. Taxpayer uses these systems at the ETC to demonstrate to prospective customers that many different types of applications and software products are fully compatible with Taxpayer equipment, customer applications, and independent software vendor's products.

B. Benchmark Testing

Benchmark testing records the execution of a series of preestablished protocols. These protocols yield scores for prospective purchasers to use in comparing the performance of one product with others configured for the same application. The Transaction Processing Performance Council (TPC), an industry organization, sets the protocols for TPC benchmarks, which are the leading application and industry standards. The TPC makes its benchmark protocols publicly available for use by manufacturers to test their products. Anyone may publish their benchmark results. The TPC requires complete documentation of the tests for TPC review, and vendors must publicly withdraw results of benchmark tests that the TPC concludes were executed improperly or unfairly.

Taxpayer runs TPC performance benchmarks on the systems configured at the ETC, and then publicizes the results. Prospective customers use the test results to determine whether Taxpayer's system can perform at the required level and to compare the performance of its systems with those produced by competitors.

Ruling Request

Taxpayer requests a ruling that Taxpayer's withdrawal of items from sales inventory for combination into large, uniquely configured computer systems, Taxpayer's operation of those computer systems to show the systems' capabilities to prospective customers or to benchmark industry standards, and Taxpayer's subsequent return of the items to sales inventory constitutes demonstration while holding the items for sale in the regular course of business and is not a taxable use.

Discussion

Massachusetts law imposes a use tax on the storage, use or other consumption in Massachusetts of tangible personal property purchased for storage, use or other consumption in Massachusetts at the rate of five percent of the sales price of the property. G.L. c. 64I, § 2. The term "store" or "storage" is defined as "any keeping or retention in the commonwealth for any purpose except sale in the regular course of business or subsequent use solely outside the commonwealth of tangible personal property purchased from a vendor." G.L. c. 64I, § 1. "Use" is defined to include "the exercise of any right or power over tangible personal property incident to the ownership of that property, except that it does not include the sale of that property in the regular course of business". *Id.*

Retention, demonstration, and display are normal uses of property held for sale in the regular course of business and are thus non-taxable. See G.L. c. 64I, § 8(e)(retention, demonstration, or display while holding property for sale in the regular course of business does not defeat the presumption of non-taxability arising from furnishing a resale certificate to a vendor). If, as Taxpayer asserts, Taxpayer only used the items for demonstration or display while holding them for sale in the regular course of business, Taxpayer's use is not taxable.

There is no statutory or regulatory definition of "demonstration" as used in G.L. c. 64I, § 8(e), and the courts of the Commonwealth have not defined the term. Where a term has acquired no technical meaning or is otherwise undefined, the term should be given its usual and accepted meaning, G.L. c. 4, § 6, Third, as long as this meaning is consistent with the statutory purpose. *Commonwealth v. Zone Book, Inc.*, 372 Mass. 366, 369 (1977). "Usual and accepted meanings are derived from . . . their use in other legal contexts and dictionary definitions." *Id.*

The American Heritage Dictionary of the English Language (1985) defines:

demonstrate: . . . 2. To describe or illustrate by experiment or practical application: *demonstrate the effect of a drug*. 3. To show or reveal. 4. To display, operate, and explain (a product).

Id. (original emphasis).

Operation of a uniquely configured computer system to show a customer that the system is suitable for the customer's requirements is both "[t]o describe or illustrate [the computer system] by experiment or practical application" and "[t]o display, operate, and explain [the computer system]."

Taxpayer's use of items taken out of inventory for establishment of industry standard benchmarks and publication of the results is "[t]o describe or illustrate by experiment or practical application " the performance characteristics necessary for customers to make comparisons among products. Both of these uses of the computer system fall squarely within "demonstration" and do not constitute retail sale of the computer system.

Conclusion

Taxpayer's removal of items of tangible personal property from sales inventory, use of those items at the ETC as components of systems demonstrated to customers and benchmarked by industry standards, and subsequent return of the items to sales inventory is a use of the property for the purpose of demonstration while holding such property for sale in the regular course of business. The items withdrawn from sales inventory are not subject to the use tax.

Very truly yours,

/s/Frederick A. Laskey

Frederick A. Laskey
Commissioner of Revenue

FAL:DMS:rv

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